IN THE

United States Circuit Court of Appeals

For the Ninth Circuit

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J. A. McPherson,
Petitioner,
vs.
Commissioner of Internal Revenue,
Respondent.
No. 6550

J. H. Leighton,
Petitioner,
vs.
Commissioner of Internal Revenue,
Respondent.
No. 6551

PETITION FOR A REHEARING ON BEHALF OF PETITIONERS.

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FILED
FEB - 4 1932
PAUL P. O'BRIEN,
CLERK

Pernau-Walsh Printing Co., San Francisco

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PETITION FOR A REHEARING ON BEHALF OF PETITIONERS.

To the Honorable Curtis D. Wilbur, Presiding Judge, the Honorable William H. Sawtelle, Associate Judge, and the Honorable William P. James, District Judge, Judges of the Circuit Court of Appeals for the Ninth Circuit:

The petitioners respectfully petition this Honorable Court for a rehearing of the above entitled proceedings, and in support thereof and as grounds therefor, respectfully show that the Court erred in its opinion and order herein as follows:

(1) The opinion and order are based upon assumptions of fact contrary to the unchallenged findings of the Board of Tax Appeals;

(2) The respondent elected to enforce the liability of the petitioners as former stockholders, and not as fiduciaries. The distinction is fundamental, and not a mere matter of form.

(3) The opinion and order are at variance with the law of California with respect to dissolved corporations and the powers of surviving trustees, and also with prior decisions of this Court.

I.

THE OPINION AND ORDER ARE BASED UPON ASSUMPTIONS OF FACT CONTRARY TO THE UNCHALLENGED FINDINGS OF THE BOARD OF TAX APPEALS.

The material departures from the unchallenged findings by the Board are as follows:

1. On page 2 of the opinion, it is stated that *before** the corporation was dissolved, the assets thereof were converted into cash, and such cash distributed to the stockholders. This is contrary to the following finding of the Board (Tr. p. 24):

> "Upon dissolution, the petitioners, as stockholders, received in liquidation the amounts shown below:"

The record therefore shows that the distribution occurred after dissolution, in accordance with law, and not prior to dissolution, or contrary to law.

*Italics throughout are ours.

2. On page 2 of the opinion, the following appears:

> "On March 15, 1920 (after the dissolution proceedings) a tax return was made on behalf of the corporation, which was signed by the two petitioners as corporate officers."

Earlier in the opinion the fact is recorded that the dissolution occurred June 25, 1920, and obviously any return filed on March 15, 1920, was made *before* dissolution, and therefore properly made in the name of the corporation and signed by its officers. The Board so found (Tr. p. 24):

> "On March 15, 1920, the *corporation* filed a return for 1919 on Form 1065—Such return being signed by J. H. Leighton and Jas. A. McPherson, as officers of the corporation."

If the facts were as stated in the opinion, the principle of *Lucas v. Hunt,* 45 Fed. (2d) 781, might well be applied, for then there would have been not only a misleading return, but a misrepresentation of fact. But the return was *properly* made by the corporation, and the dissolution was *followed* by the distribution, all in accordance with law, some five years before the Commissioner decided to assess a tax.

In 1920, when the return on Form 1065 was filed, the corporation believed it was entitled to personal service classification under Section 218 of the Act of 1918 and, in fact, was so advised by the Collector at San Francisco. It was not until 1924, as a result of a series of decisions, that the Commissioner concluded to deny such classification to all dairy lunch and cafe-

teria enterprises. No tax was due under the original return but, instead, an alternative tax was paid upon the income by the stockholders. Consequently, at the time the various proceedings were had, every step was in conformity with law, and the equities, if important, are all with the petitioners and not the Government. Moreover, the Board did not find fraud or anything else which might justify an estoppel and if this proceeding involved an ordinary creditor, other than the Government he would promptly be denied relief because of laches in the disclosure and enforcement of his claim. We believe the Court should grant a rehearing and afford petitioners a judicial review based upon the facts as found by the Board.

II.

RESPONDENT ELECTED TO ENFORCE THE LIABILITY OF PETITIONERS AS FORMER STOCKHOLDERS, AND NOT AS FIDUCIARIES; THE DISTINCTION IS FUNDAMENTAL AND NOT A MERE MATTER OF FORM.

At page 4 of the opinion, the Court holds to be a mere matter of form the fact that the notice of deficiency and assessment were made in the corporate name and not in the name of the surviving trustees. In reaching this conclusion, we believe the Court failed to give proper weight to the following:

(a) Section 280 provides for two distinct types of proceeding. Under subdivision (a) (1) thereof the liability of former stockholders as *transferees* may be enforced. At the option and *election* of the Commissioner, under subdivision (a) (2) the liability of

surviving trustees as *fiduciaries* under Revised Statutes 3467 may be enforced. The first relates to the liability, *"at law or in equity,"* of a former stockholder to deliver up assets to satisfy a corporate debt. The second relates to a liability *created by statute,* and is based upon the statutory obligation of a fiduciary to pay a Government debt before he distributes corporate assets. Said section of the Revised Statutes provides as follows:

> "Every executor, administrator, or assignee, or other person, who pays any debt due by the person or estate from whom or for which he acts, before he satisfies and pays the debts due to the United States from such person or estate, shall become unanswerable in his own person and estate for the debts so due to the United States, or for so much thereof as may remain due and unpaid."

Petitioners, in their capacity as surviving trustees of a dissolved corporation, were fiduciaries with respect of corporate assets coming into their hands for distribution. The waiver herein shows that they were such. The Commissioner was put to an election, when he commenced his proceeding under Section 280, as to whether he would proceed against stockholders as transferees under subdivision (a) (1) or against one or more of the surviving trustees as fiduciaries to enforce a liability under Section 3467. That he elected to disregard the fiduciary liability of the surviving trustees and to proceed against the petitioners and other persons as *stockholders,* clearly justifies this Court in now holding that such election renders im-

material the fact that the petitioners were surviving trustees or fiduciaries, as well as stockholders. Moreover, the Board has found that these proceedings were against the petitioners as transferees, or stockholders, and the Court should be bound thereby. To hold otherwise eliminates the requirement of Section 280 that the Commissioner must elect as to which type of proceeding shall be commenced, and places stockholders who happen to have been directors in a position where a statutory liability—in the way of a penalty—may be claimed in a judicial review even though it was never disclosed in, or recognized by, the fact-finding body, the Board.

(b) The authority of the Commissioner to impose taxes under prior acts and to bring the procedural provisions of Section 280 into play against transferees and fiduciaries, is contained in Section 283 of the Act of 1926, and is as follows:

> "If after the enactment of this act the Commissioner determines that any assessment should be made in respect of any * * * tax * * * the Commissioner is authorized to send by registered mail *to the person liable* for such tax notice of the amount proposed to be assessed, which notice shall, for the purposes of this act, be considered a notice under subdivision (a) of section 274 of this act."

Since Section 280 requires that a *person liable* thereunder shall be assessed in the same way as a taxpayer, and Sections 274 and 283 require that the notice shall be addressed to the *"person liable,"* it follows that a notice addressed to some other person

can not be considered as sufficient to meet the statutory requirement. To so treat a notice addressed to another, amounts to an addition to the statute, which is inconsistent with its express provisions.

The Board of Tax Appeals has held repeatedly that only the person or corporation named in a notice of deficiency may appeal therefrom, and it is logical to say that if a person cannot appeal from a notice, the notice should not be treated by the Court as binding upon such person.

In *Estate of Liberman v. Commissioner,* decided by the Second Circuit on December 14, 1931, and not yet reported, it was held that where the deficiency notice was addressed to an incompetent who had died, the guardians of such incompetent had no right of appeal and could not treat the notice as though addressed to them. Quoting from that decision:

> "* * * Section 274 of the Revenue Act of 1924—under which the taxes accrued—provides for the notice to 'the taxpayer' of a deficiency determined by the commissioner and permits the 'taxpayer' to file a petition with the Board of Tax Appeals for a redetermination of the deficiency. There is no provision in the 1924 Act making the committee of an incompetent the taxpayer. The incompetent remains the taxpayer, although the committee is obliged to make a return for him. So the Board held * * *"
>
> "Section 283 authorizes the commissioner to assess any tax accruing under earlier revenue acts and to send by registered mail to 'the person liable for such tax' notice of the amount proposed to be assessed. * * *"

It is to be noted that the Court strictly construed the language of Section 283, and held that since the notice was not addressed to the guardians, they could not appeal. Under the California law when a corporation is dissolved it is dead for all purposes, and no proceedings can be taken in its name or behalf. The statutory trustees take the assets, but only for the stockholders and creditors. Since all proceedings abate upon dissolution, necessarily no right of appeal existed in the trustees.

Therefore, where the statute directs that the notice shall be mailed to the *person liable,* the Court should not read into the statute a further provision that it may be addressed to someone else who is entirely without power to do anything with reference to it, —in this case, the dead corporation.

(c) The rule that tax statutes and provisions of limitation therein must be construed liberally in favor of the taxpayer and against the Government has been repeatedly stated by the Supreme Court. In *United States v. Updike,* 281 U. S. 489, the rule is summarized as follows:

> "It may be that the saving clause was not strictly necessary, but was inserted from excessive care to put the right of the taxpayer beyond dispute. In any event, we think this is the fair interpretation of the clause, and the one which must be accepted, especially in view of the rule which requires taxing acts, *including provisions of limitation embodied therein,* to be construed liberally in favor of the taxpayer."

The extent of the rule was recently restated in *Crooks v. Harrelson,* 282 U. S. 55, at 61, as requiring

a strict compliance with the wording of the statute to validate a proceeding thereunder. Quoting from said decision:

> "Finally, the fact must not be overlooked that we are here concerned with a taxing act, with regard to which the general rule requiring *adherence to the letter* applies with peculiar strictness. In *United States v. Merriam,* 263 U. S. 179, 187-188, after saying that 'in statutes levying taxes the literal meaning of the words employed is most important, for such statutes are not to be extended by implication beyond the clear import of the language used,' we quoted with approval the words of Lord Cairns in *Partington v. Attorney-General,* L. R. 4 H. L. 100, 122, that 'if the Crown, seeking to recover the tax, cannot bring the subject *within the letter* of the law, the subject is free, however apparently within the spirit of the law the case might otherwise appear to be. In other words, if there be admissible in any statute, what is called an equitable construction, certainly such a construction is not admissible in a taxing statute, where you can simply adhere to the words of the statute.' "

The specific requirements of Sections 274 and 283 that *the notice must be sent to the person liable,* leaves no room for interpolating an exception, for the incidence of liability depends upon "adherence to the letter" of the statute, and even if an equitable construction might justify an exception, it is not "admissible in a taxing statute where you can simply adhere to the words of the statute."

If such principles of construction do not mean that the Commissioner, if he intends to enforce a fiduciary

liability must address the notice to the person so liable, and not to the dissolved corporation, then they are mere meaningless generalities and should be expressly repudiated.

The moment the waiver was filed, the Commissioner knew that the corporation was dissolved—for it so stated, and was signed by "surviving trustees." Mistakes of law do not give rise to equitable considerations, but, as held in *Estate of Liberman,* supra, the waiver imputed notice of California law to the Commissioner, that all proceedings against it abated because of its death, and that he would have to look elsewhere for the tax.

Considering the requirements of the statute, the findings of the Board, and the rules of construction, we believe there is no basis for taking cognizance of the fact that petitioners were trustees as well as stockholders. But, on the contrary, the notice must be construed to be, what the statute expressly declares it is, *one to a dissolved corporation,* and not one to enforce a liability under R. S. 3467, against the surviving trustees as fiduciaries, or against individuals as stockholder-transferees. *Naming the addressee of the notice, therefore, is decidedly not a mere matter of form, but is, indeed, "one attended by substantial differences."*

III.

THE OPINION AND ORDER ARE AT VARIANCE WITH THE LAW OF CALIFORNIA WITH RESPECT TO DISSOLVED CORPORATIONS AND THE POWERS OF SURVIVING TRUSTEES, AND ALSO WITH PRIOR DECISIONS OF THIS COURT.

Whether surviving trustees act for an indefinite time after the dissolution of a corporation is, we believe, a question not involved in these proceedings. In any case, such trustees act for the *creditors* and *stockholders,* and not for the dissolved corporation. This distinction is fundamental, as shown by the decisions of the California Courts, which, so far as this question of local law is concerned, are binding upon the Federal Courts.

The notice of deficiency, addressed to the dissolved corporation, and the assessment subsequently made against the dead corporation, did not purport to assert a liability against the stockholders as transferees of the corporate assets, or a liability against the surviving trustees as fiduciaries under Revised Statute 3467. The first notice merely proposed an assessment against the dead corporation, and the assessment subsequently made merely assessed a tax against that corporation. Since the corporation was defunct, and no proceedings could be taken in its name or on its behalf, obviously the proceeding so taken against the corporation might have formed the basis for a suit in equity to reach the assets in the hands of the stockholders or others, but beyond that they could not go, in view of the death of the corporation.

We have shown that the notice of deficiency must be addressed to the person against whom the liability

is asserted, and that only such person, when addressed, may appeal from an assessment proceeding. Under California law, the surviving trustees were without power to sue in the name or on behalf of the dissolved corporation. Moreover, the notice did not assert a liability against them.

In *United States v. Loflin,* 24 Fed. (2d) 683 (cited in the opinion herein), the United States sought to make a dissolved corporation a party plaintiff instead of the surviving trustees, and it was there held that this could not be done under California law, for the trustees were in the suit representing the stockholders, and not the corporation. While the case shows that surviving trustees may act at any time and from time to time whenever corporate assets or receivables come into their hands, we believe the Court is in error in construing the case as holding that surviving trustees have any power whatever if there are no assets in their hands. Their trust is statutory and limited by the provisions of C. C. 400. When assets are passed from the hands of the surviving trustees, there is nothing remaining upon which the trust may operate, and, consequently, there is nothing the trustees may bind on behalf of the creditors or stockholders. If, at some later date, additional receivables come into their hands, like the cause of action which was the subject matter of the *Loflin* case, obviously they have the power to bind the creditors and stockholders whom they represent to the extent of the particular chose in action or receivable.

Capuccio v. Caire, 189 Cal. 514.

All of the assets of the corporation ever coming into the hands of the surviving trustees in these proceedings were distributed five years before the waiver was executed. Obviously the trustees had no assets to bind at the time they executed the waiver, and therefore the waiver could not be effective for any purpose. Moreover, the waiver purports to be a corporation waiver and not one given by the surviving trustees in behalf of the stockholders, and for that reason the Court should not read into the waiver a contract between the Government and the former stockholders, which simply is not there.

In *Oklahoma Gas Company v. Oklahoma,* 273 U. S. 257, it is held that the law of the jurisdiction which gives life to a corporation is determinative and binding upon the Federal Courts. Such was also the holding in *Estate of Liberman,* supra, recently decided by the Second Circuit.

In *Crossman v. Vivienda Water Company,* 150 Cal. 575, and other cases cited in petitioners' brief, it is stated as emphatically as can be that *once a California corporation has been dissolved it is dead for all purposes,* and no proceedings can be taken in its name or on its behalf, whether affirmative or negative.

In *Nezek v. Cole,* 43 Cal. App. 130 at 138, it is held that a dead corporation can make no admission or estoppel, nor can it authorize "anyone else to do so for it," for all actions and proceedings abate against the corporation upon its dissolution. To hold that the waiver given by the surviving trustees serves to validate a subsequent assessment made against the

corporation ignores the fact that under California law no proceedings could be taken on behalf of a dissolved corporation. This demonstrates the invalidity of the waiver herein, and also, the error of holding that the notice of deficiency and assessment made against the dead corporation should be construed as having been addressed to the surviving trustees for, as held in the *Crooks* case, the tax statute involved is not susceptible of any such construction.

We ask also that the Court again consider *Lucas v. Hunt,* supra, *United States v. Kemp,* 12 Fed. (2d) 7, *Commissioner v. Godfrey,* 50 Fed. (2d) 79, all cited in the opinion, for each of these cases is distinguishable upon the facts. In the *Lucas* case there was no disclosure of the dissolution, but, on the contrary, the waiver represented that the corporation was an existing one, which completely distinguishes that case and its doctrine from the present proceeding; for the waiver here disclosed the fact of dissolution and that the persons signing were merely surviving trustees of the dead corporation.

In the *Kemp* case, the corporation was dissolved on May 17, 1921, and under the laws of Texas its existence continued for a period of three years for purposes of liquidation, or, until May 17, 1924. The waiver involved was made within that time, and therefore was a valid waiver under the laws of Texas, and bound the corporation as effectively as though the dissolution had not taken place, because the corporate entity had not been discontinued. The same is also true of the *Godfrey* case, for at page 80 the Court held:

> "Under these statutes, *the corporation's existence continued* until the corporation's affairs were closed."

It will be noted that in each of the cases cited, the Court applied the corporation law of the local jurisdiction, with reference to the termination of corporation's existence. Under the California law it is equally well settled, as held in *Crossman v. Vivienda Water Company,* supra, that there is no continuation of existence after dissolution—the corporation simply dies, is dead, and no proceeding of any kind can be taken in its name or behalf.

In the last mentioned case, the Court goes further and draws a distinction between the California law and that of other jurisdictions.

In the opinion herein, it is indicated that the Government was placed at a disadvantage by acting upon the waiver, and that the trustees hoped to derive some benefit for themselves or for "the interests they represented." In reaching this conclusion, we believe the Court failed to consider that all proceedings abate against California corporations upon their dissolution, and the trustees are without power to act in its name or in its behalf. The fact that the waiver was given by the surviving trustees and accepted by the Commissioner under a mistake of law does not give rise to any equitable considerations, nor does it warrant making out of the waiver a new contract. *Immediately after such dissolution, the Commissioner of Internal Revenue had but one remedy, viz., a suit against the stockholders to compel them to pay the tax out of the assets distributed to them upon disso-*

lution, or to enforce the fiduciary liability against the surviving trustees under Revised Statutes 3467. Such remedy was in no way affected by the waiver, and there has been no showing by the respondent why he did not proceed in a timely suit. The fact that he waited until new legislation was adopted, and then proceeded thereunder, does not justify this Court in now holding that because of such subsequent legislation the petitioners are not to have the benefit of the law and facts existing when the waiver was given. No remedy created by subsequent legislation can work an estoppel with reference to transactions taking place under a prior law, yet that is in effect the holding of this Court. Even a subsequent taxing act will not be given effect so as to change completed transactions. (*Shwab v. Doyle,* 258 U. S. 529 at 536.)

Therefore, it is plain, that the Government was in no way prejudiced for its remedy was not affected by the waiver. The waiver purported to be exactly what it was, an invalid corporate waiver, putting the Commissioner on notice. The Court should not now remake the waiver in order to validate a proceeding under subsequent legislation not contemplated when the waiver was given.

Although the case of *California Iron Yards Co. v. Commissioner,* 47 Fed. (2d) 514, was relied upon in our brief, it is not mentioned in the opinion herein. The case upholds the validity of a waiver executed by a corporation at a time when it had been *suspended* for failure to pay its license tax. The distinction is there drawn between a *suspended* corporation and a *dissolved* corporation, and it is held, in

accordance with the law of California, that *if the corporation had been dissolved, the waiver would have been invalid,* "for the same reason that a dead person could not act under laws authorizing living individuals to act."

We submit that under the decision rendered in these proceedings, the whole of the opinion of Presiding Judge Wilbur in the *California Iron Yards* case, necessarily becomes dictum, because if there is no distinction between a *suspended* corporation and a *dissolved* corporation in California, then manifestly the distinction drawn in that opinion is without foundation. The *California Iron Yards* case is in conformity with the settled law of California, and we believe that upon reexamination of that decision no other conclusion is possible than that it states sound principles of law which should be followed by the Court in the disposition of these proceedings.

Nowhere in the Act of 1918 or in the Act of 1926 is there any provision authorizing the application of an estoppel in tax matters, and, as held in the *Updike* and *Crooks* cases, supra, there is no room for the application of equitable principles in the interpretation or application of a taxing act, even in a case where the facts would otherwise justify equitable considerations. This is not such a case; for, as already shown, the proceedings following dissolution were taken in entire good faith and at a time when personal service classification was deemed allowable to corporations of this kind. The waiver, filed at the request of the Government, was under a mutual mistake of law, and *did not*

affect any remedy of the Government then existing. The Court should not now revamp the waiver into a contract between the surviving trustees and the Government, nor should it treat these proceedings against fiduciaries for the enforcement of a statutory liability, when the most the Commissioner ever intended, as clearly appears in the findings of the Board, was to commence proceedings to enforce the liability of stockholders as transferees under the trust fund theory.

We believe the various matters set forth herein should persuade the Court to grant a rehearing in this matter, since the effect of its opinion and order is to convert this from a transferee to a fiduciary proceeding, and further to disregard and set aside the long-settled and accepted principles of California law, heretofore accepted by the Federal Courts, relating to dissolved corporations, and the powers of surviving trustees.

Dated, San Francisco,
February 3, 1932.

Respectfully submitted,
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Certificate of Counsel.

I hereby certify that I am of counsel for petitioners in the above entitled cause and that in my judgment the foregoing petition for a rehearing is well founded in point of law as well as in fact and that said petition for a rehearing is not interposed for delay.

Dated, San Francisco,
February 3, 1932.

Herman Weinberger,
Of Counsel for Petitioners.